TASMANIA

GOVERNMENT
PRICES
OVERSIGHT
COMMISSION

Metro Fares Investigation

Final Report

February 1997

Summary and Recommendations

The Government Prices Oversight Commission Investigation of Metro fares is a major departure from the way these fares have previously been set. Under the National Competition Principles agreed by Australian Governments, prices for services provided by monopoly Government Business Enterprises are to be scrutinised by independent bodies. Public participation and review are important parts of the new process, as is the requirement for the Commission to publish its recommendations and the reasons for them.

The Metro Fares Investigation took place during a time of major review of public transport in Tasmania. The report of the Burton Committee released in December 1996 recommended fundamental changes to the way urban public transport services should be provided in Tasmania. One of its proposals was that the MTT should retain an exclusive franchise for its routes for up to 10 years. This would give the Government time to establish a framework for the future provision of services by the public and private sectors.

The Government has indicated support for the concept of a limited franchise for the MTT. The Government has also advised that there is no specific response to the Burton Report that the Commission is required to take into account in developing its pricing recommendations.

In December 1996, the Minister for Transport announced that the Government believed it was necessary to consider options for improving public bus services in the State. One option included privatisation of the State's public bus system. The Minister has asked the Board of the MTT to put forward a proposal for a public bus transport system which would be efficient, encourage more patrons and offer improved services.

While these developments have no direct bearing on the Metro Fares Investigation, it is clear that the environment in which the Metro operates could change substantially.

Recommendation of Maximum Revenues

The Commission's primary recommendation concerns the maximum revenue the MTT needs from fares and Government contributions to deliver the services required by Government. This revenue should be

no more than that required to meet an efficient level of costs and to provide a commercial return on an optimum set of assets.

The Commission recommends that the total revenue from fares and Government contributions be no more than $28 099 000 per annum (expressed in 1996-97 currency) for the current levels of timetabled services required of the MTT.

This amount is derived from ‘benchmark costs’ which the Commission believes could be achieved by the MTT in an environment where other operators could compete to provide transport services. The Commission notes that achievement of the benchmark costs would require substantial change in conditions of employment and changes in the environment in which the MTT operates.

Benchmark operating costs are approximately $2 million (8 per cent) less than MTT budgeted costs. Most of the difference is attributable to driver labour costs. These would need to reduce by 15 per cent to meet benchmark levels and would require both changes in employment conditions and gains in productivity.

MTT budgeted ownership costs are made up of depreciation and financing costs, but do not include a return on funds employed in the business. Benchmark ownership costs include depreciation charges and an allowance for a commercial return on assets necessary to provide the current level of services. Benchmark ownership costs are greater by approximately $2 million per annum, most of which is due to the return on assets that would be expected in a commercial operation.

In aggregate, benchmark costs are comparable with MTT budget estimates for 1996-97. Achievement of productivity improvements and cost reductions should enable the MTT to generate a profit and a return on funds invested in the business.

The Commission also considers that financial arrangements between Government and the MTT should be on a commercial footing. Although the way in which public transport services are to be delivered is under review, the Commission recommends that Government consider an agreement with the MTT for the amounts of Government contribution to be paid for services for each of the three years of prices oversight, subject to a pre-determined basis for adjustment.

These arrangements would bring a commercial discipline to Metro’s operations. Improvements in financial performance by containing costs and increasing patronage would be visible in MTT profitability statements. Financial arrangements between Government and the MTT would be on a commercial arms-length basis, just as they would if another provider entered into a contract to provide an agreed level of urban transport service.

Recommendations in regard to Fares

Fares currently account for only 25 per cent of MTT operating revenues. Government subsidies of $19.3 million per annum represent almost two-thirds, made up of a subsidy for student and other concessions and funding of the MTT operating deficit.

The amount that passengers should contribute to Metro operations will be determined by Government policy on funding of the MTT. Non-commercial activities which the Government requires the MTT to undertake will be identified and funded as Community Service Obligations (CSOs). The process of determining CSOs is not yet complete. The Commission cannot make specific recommendations on fares without information on the future level of Government contribution.

The Commission recommends that adult fares should be set according to the following principles:

(i) Fares should increase overall as the existing level of cost recovery from users of Metro services cannot be justified in economic terms.

(ii) The fare for 11 - 15 sections of travel should be 2½ to 3 times that for 1 - 2 sections, with appropriate intermediate gradations of fares for other section groupings.

(iii) Section boundaries should be adjusted to obtain a better relationship between the number of sections and distance travelled.

(iv) Fare adjustments should be small and regular (ie annual).

The Commission does not consider that it is necessary to specify maximum prices for the range of discount fares offered by the MTT. Discounts for multiple-trip and off-peak travel should be a commercial decision for the MTT. Current MTT policy for Metro 10 Trip tickets is

Table 1: Indicative Schedule of Adult Fares	
	All Locations All Periods $
Adult 1 - 2 sections	1.40
Adult 3 - 4 sections	1.90
Adult 5 - 7 sections	2.30
Adult 8 - 10 sections	2.80
Adult 11 - 15 sections	3.60
10 Trip	8 times above fares

consistent with practices of other operators, reflecting cost savings and loyalty incentives.

The criteria for eligibility and level of concession fares is a matter for Government to determine as part of its social policy. The Commission notes that the criteria for eligibility for concession fares is broadly consistent with those of other jurisdictions. However, the structure of concession fares in Tasmania is unique. The Metro concession fare is set equal to the 1 - 2 section adult ticket. Most other jurisdictions offer a percentage discount (50 to 60 per cent) of the equivalent full adult fare. This means that Tasmanian concession card holders pay more for short distances and less for longer distances than do those of other jurisdictions.

Indicative Fares

The indicative fare schedule shown in Table 1 incorporates the Commission’s recommended principles for setting fares, and current MTT practice on discount and concession tickets. This schedule of fares improves the relationship between costs and fares though the aggregate revenues would continue to fall well short of those necessary for full cost recovery.

Increases in longer-distance fares are moderated to limit the impact on passengers in outer suburbs.

The expected impact of this schedule on fare revenue and patronage is shown in Table 2.

(1) Includes 1.3 million free student first boardings

Table 2: Fare Revenue and Patronage			
	Revenue $m	**First Boardings millions**	**Reduction in Patronage %**
Adult	3.8	2.1	7
Student	2.9	3.8(1)	3
Concession	2.9	2.6	7
Total	9.6	8.5	6

These figures illustrate that increases in fares are likely to be accompanied by a long-term loss of patronage. The net result would be an increase in fare revenue of about $0.9 million per annum, or 10 per cent. The amount of Government funding necessary to maintain the current level of services would decrease by the same amount. This means that significant increases in fares would have relatively little impact on the amount of Government funding that is necessary to maintain the existing level of services.

Performance Measures

In an environment where there is an emphasis on commercial performance, it would be appropriate to monitor service delivery to ensure that the quality of service continues to meet acceptable standards. The MTT proposes to develop a Customer Services Charter which may address these issues.

The Commission considers that the MTT should develop a set of performance measures for periodic reporting of quality of service. These measures should include reliability of service, and standards for condition and cleanliness of buses and route infrastructure.

Metro Services

Many submissions to the Background Paper and the Draft Report commented on the frequency and availability of Metro services. Reductions in the level of service that were implemented by the MTT in September 1996 created concern and a vociferous response from some sections of the community.

It is apparent to the Commission that service decisions which are primarily driven by cost considerations will not satisfy community demands. However, providing scheduled route services for occasional travellers on poorly patronised routes may not be the best means of meeting community needs.

There is a continuing trend of reduced use of Metro services. The profile of Metro travellers is shifting from full fare-paying passengers to concession travellers. The present services were developed for an era of high and regular use of urban public transport. They no longer satisfy the demands of a growing proportion of Metro passengers.

Some of the solutions may not lie with the Metro. Community transport, for example, may be a better means of servicing the

occasional needs of the elderly and others who do not have access to private transport.

These matters are outside the scope of the Metro Fares Investigation, but are important issues for a growing section of the community. The Investigation focussed on the efficiency of delivery of timetabled MTT services. Further investigation of transport needs would be required to identify effective ways of meeting the travel needs of public transport users.

Submissions

The Background Paper

Thirty-six submissions were received in response to the Background Paper released in October 1996. The majority of these came from private citizens and interest groups.

Twenty-five of these focussed on the services the Metro provides, expressing concern about the impact the September 1996 reductions in service had on student and youth evening users, daytime elderly users and workers travelling outside peak times.

A number of submissions also suggested ways to improve services. These included park and ride facilities, inter-regional routes and mini-bus services.

Metro has proposed a number of initiatives to increase patronage through a better match of services and needs. These included extension of high frequency midi bus services, and examining the potential for park and ride, hail and ride and demand responsive services.

Most of the 22 submissions which commented on fares considered that the present levels were too expensive. Some considered that current fares were acceptable and could even be increased slightly. The Northern Metro Advisory Group considered that another rise in fares so soon after the July 1996 increase could cause further loss in patronage.

Many submissions referred to the inter-relationship between Metro services and other urban transport issues. Some considered that urban public transport should be subsidised just as car users are ‘subsidised’ because they do not ‘pay their way’. The Commission’s research indicates that any subsidy for this reason would be considerably lower than the current level of subsidy.

The MTT submission noted that convenience, price and comfort were the main factors influencing people's choice of transport. The MTT stressed that its operating costs were the lowest of the publicly owned bus operators in Australia, and that legislation bound the MTT to costs that exceeded those attained in the private sector.

The MTT proposed that the current distance-based sectional fare structure and, at least in the short term, existing fare types be maintained.

The Draft Report

The Commission received fourteen submissions on the Draft Report. Again, most of these were from private citizens (usually passengers) and special interest groups.

Twelve submissions addressed issues relating to fare levels and structures or ticket types. Seven commented on service issues.

Little support was given for any of the fare options outlined in the Draft Report. More generally, an increase in Metro fares was not supported and preference was given for a simple fare structure. Most submissions did not support the idea of different fare structures in the three Metro regions.

Submissions again emphasised that service issues, such as service frequency, are currently of much more importance to passengers than fare levels. They also reflected a general community attitude that it was appropriate for Government to provide a good quality public transport system.

MTT Finances

Approximately one-quarter of MTT revenues are obtained from fares. Two-thirds ($19.3 million in 1996-97) come from Government funding for concessions and deficit funding. The Government's contribution is $2 million per annum less than the levels of 1993-94, due to an increase in revenue from fares and a reduction in operating expenses. Cost per kilometre has reduced by 11 per cent in real terms from the levels of 1992-93. Payroll and on-costs represent 60 per cent of MTT operating expenses.

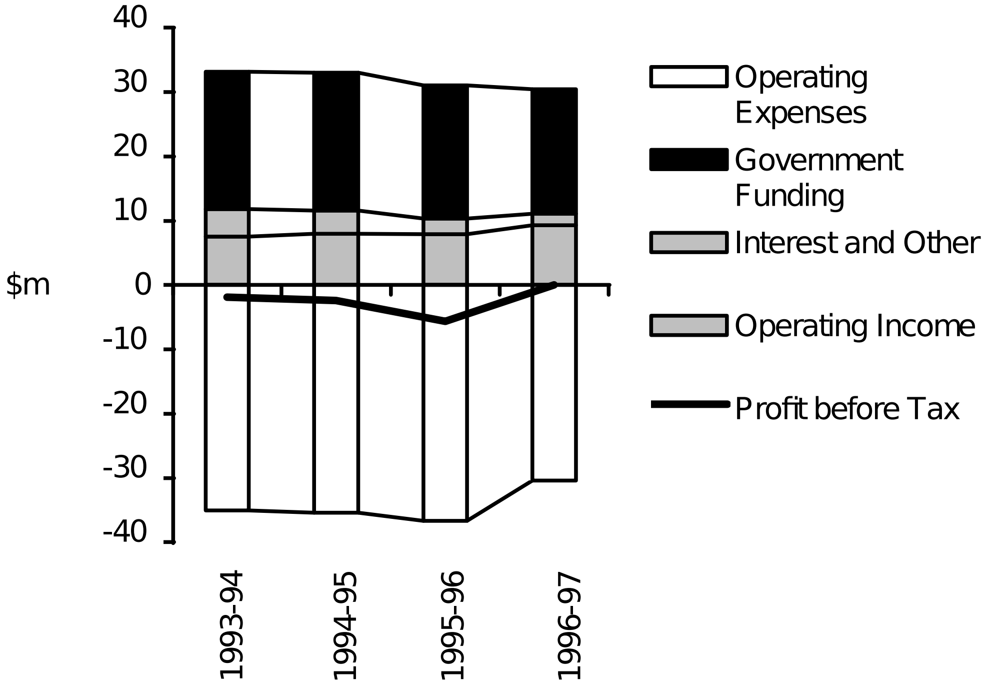

Figure 1: MTT Financial Performance

The value of invested funds has reduced from $28.8 million at 30 June 1994 to $16.5 million at 30 June 1996. Proceeds were used substantially to fund the purchase of buses when leases expired. Metro debt is relatively low in comparison with other publicly owned urban bus operators, with a debt to equity ratio of 21 per cent.

Further expenditure to purchase buses when leases expire will be the most significant item of capital expenditure in the period to 30 June 1999. Metro plans to purchase new buses in 1999-00 and 2000-01, when expenditure of $5 million in each year is forecast.

The financial performance of the MTT depends much more on Government funding than on fares. Previous funding has been provided to meet the MTT operating deficit. Future levels of funding may enable the MTT to record a profit, subject to MTT's management of its operating expenses and Government policy on financing Community Service Obligations on a commercial basis. If the current policy is maintained, the MTT will not return a dividend to Government. Neither are any payments of income tax equivalents likely, although the MTT is expected to pay $700 000 per annum in sales tax and land tax.

Benchmark Costs

The Commission developed benchmark costs by examining reforms of urban bus services in other States. In Melbourne, Adelaide and Perth, portions of the route network have been offered for tender by public and private operators. The Commission estimated benchmark costs based on outcomes that could arise from Metro operations in an environment where there is competition to provide a specified level of service. It recognised that achievement of those benchmarks would require substantial changes in the Metro's operating environment and in the terms and conditions of employment for its employees.

A survey of six public and eight private urban bus operators for 1994-95 showed that Metro's costs of operation were generally the lowest of the public operators but significantly above the average of private operators. Metro has achieved significant cost savings in real terms since the time of the survey.

The Metro's budget for 1996-97 reflects significant gains in labour productivity and anticipates a reduction in average operating costs of about 7 per cent in real terms from the levels of 1994-95. Benchmark operating costs are some 92 per cent of Metro's 1996-97 budgeted costs. This means that costs could be reduced by a further 8 per cent, or $2 million per annum, in a competitive environment.

The capital charges included in Metro's budget for 1996-97 are made up of depreciation expenses and interest charges but do not include any return on equity. For benchmark purposes, the Commission estimated the depreciation and ownership charges (including a commercial return) on an optimised set of assets.

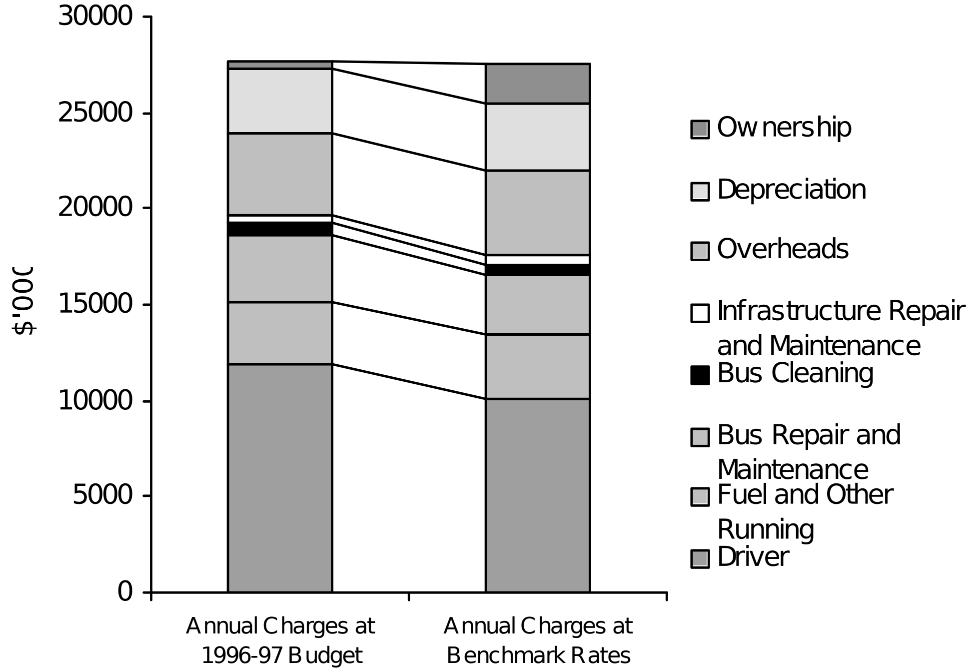

Figure 2: Annual Charges - Comparison of Benchmark Rates and Metro Budget 1996-97

The MTT submission proposed a target reduction in costs of 20 per cent, from 1994-95 to 1999-00. Some of the cost savings are expected to arise from an ageing bus fleet and lower depreciation charges, but details of potential cost savings were not provided in the submission. The MTT indicated that the Commission's estimate of potential cost reductions is broadly in line with those Metro has separately identified.

Metro Services and Patronage

MTT operates weekday services in Hobart, Launceston and Burnie, evening services in Hobart and a minor evening service in Launceston, and weekend and public holiday services in Hobart and Launceston.

Patronage, measured as first boardings, has declined slightly over the five years to 30 June 1996. While student numbers have remained relatively stable, the number of first boardings of full fare paying passengers has decreased by some 22 per cent. This has been matched by an increase in the number of concession travellers. Adult and concession travellers each represent about one quarter of Metro travellers, with students and children comprising the other half.

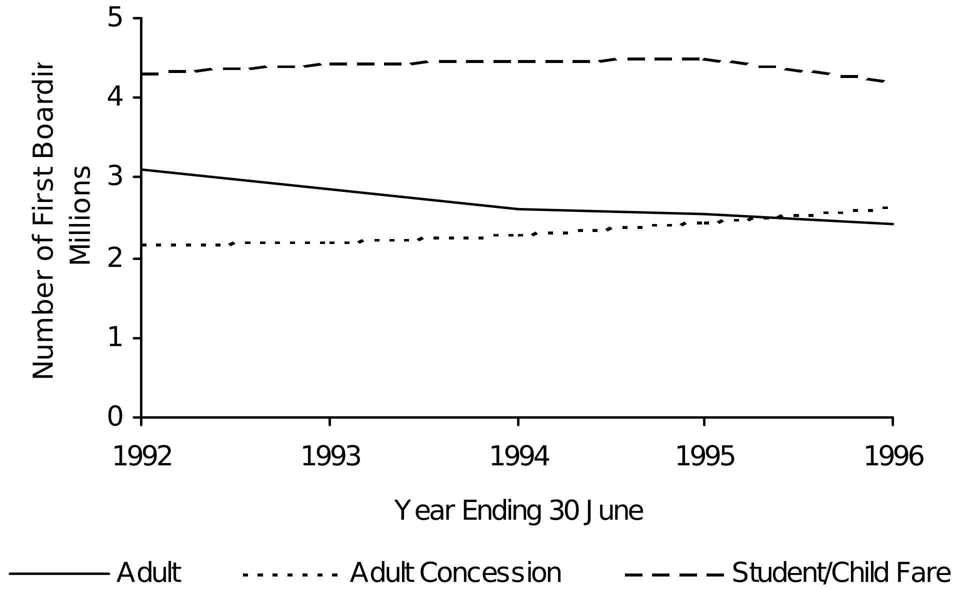

Figure 3: Metro Patronage

On 29 September 1996 a number of services were reduced. These changes affected most routes in each city, with the largest reductions on poorly patronised routes. The bulk of the reductions were made to weekend and evening services.

The Commission examined the costs and patronage of Metro services by time period and by centre. Cost recovery, the proportion of costs that is recovered from fare revenue alone, is highest in the interpeak period on weekdays, and lowest for evening and weekend services.

About 60 to 80 per cent of the Metro's patrons travel in the school and commuter peak travel times. Students and children are the predominant class of travellers at all times.

The 1991 Census showed that buses were used by 9 per cent of Hobart workers to get to work. The proportions in Launceston and Burnie were much lower. More than 18 per cent of those who work in the Hobart CBD travelled to work by bus.

Suburbs where there is an above average bus use generally have a high proportion of public housing. The use of buses is more common for workers with low incomes.

Fares and Funding

Metro's current fare schedule became effective on 21 July 1996 with fare increases ranging from 10 per cent to 37 per cent. Metro fares

lie towards the bottom of the range when compared with fares in seven other capital cities.

Metro fares are less than those charged by private operators in Tasmania for comparable distances, particularly for longer trips.

Metro services are funded from three main sources — fare revenues, Government subsidies for students and others and Government deficit funding. The Tasmanian Government currently outlays nearly $20 million on Metro funding and $20 million on private operator funding to provide public transport in Tasmania. This is about $218 per household. In contrast, about $25 million is expended each year by State and local governments for maintenance of roads in Hobart and Launceston.

Pricing Principles

The principles that need to be considered in pricing decisions include the costs of providing services, the factors that affect demand, the transport alternatives available for bus users and the practicalities of fare structures and collection of fares.

In the Background Paper the Commission stated —

> *'Fares should equal (or at least reflect) the costs of service provision so that resources are allocated efficiently between competing uses of government and private funds'.*

This principle requires prices to be set equal to the cost of the last (marginal) user of a service. These costs vary by time of day because of different penalty rates payable to drivers and because of variations in the marginal cost of providing buses. The costs per kilometre at peak periods are two to three times higher than those for interpeak periods.

Service costs also increase with distance. The current Metro fares are distance-based, but do not fully reflect the additional costs of providing longer route services.

There is an economic case for public transport fares to be set below cost if the prices of competing transport modes are also below cost. Some submissions argued that car users do not pay for the externalities of congestion, pollution and road accidents associated with the use of cars and that public transport should therefore be subsidised.

Few studies have measured the reduction in public transport fares that may be justified as a result of motorists not paying the full social

cost of individual journeys. Drawing on one recognised model, the estimated reduction of fares justified by avoided congestion for a city the size of Hobart is 15 to 30 per cent of the marginal cost. Metro fares could be increased substantially and allowance still be made for car users not paying the full social costs of their travel.

The Commission considers that section-based fare systems are preferable because of the relationship between costs and route distance. If fares for longer distance trips are not increased relative to those for shorter distance trips, a zone fare system appears to have advantages for passengers and drivers.

Fare options presented in the Draft Report included some with higher peak fares and lower off-peak fares for adult tickets. This structure would give a better relationship between costs and fares. When dedicated school services are removed, there is a less significant peak in demand by other passengers. In these circumstances and considering the greater complexity of time-based fares, a time variation in fares does not appear to be justified.

Fares charged affect the demand for bus services. In broad terms, commuter travellers are less sensitive to price than other travellers. The Commission has adopted estimates of price elasticities of -0.3 for adult peak travellers, -0.3 for student travellers and -0.4 to -0.5 for others. This means that for a 10 per cent increase in fares, patronage would drop by 3 to 5 per cent in the long term.

It is unlikely that lower Metro fares would affect the demand for car travel to any appreciable extent. In consequence, there is no justification for decreasing fares as a means of reducing the externalities of car use.

Research in other places suggests that patrons are more responsive to changes in travel time and frequency of service than they are to price. Changes in the nature of services and increases in the levels of service may have more effect on increasing the use of public transport than maintaining the current levels of fares.

Conclusion

The Government Prices Oversight Commission has examined MTT costs and fares compared with those of Tasmanian private operators and public bus operators in Australian capital cities. It has also considered the principles that would deliver a better relationship between fares and the costs of providing Metro services.

Benchmark costs have been used to recommend the maximum revenue from fares and Government contribution that would be appropriate for the MTT to deliver the current levels of services.

The Commission also considers that—

- financial arrangements between the MTT and Government should be on a commercial footing in the form of a contract for services;
- fares could increase as the existing level of cost recovery cannot be justified in economic terms;
- section boundaries should be adjusted to obtain a better relationship between sections and distance travelled;
- fare adjustments should be small and regular; and
- that the MTT should develop a set of performance measures for periodic reporting on the quality of service.

This completes the Commission's investigation of MTT prices and pricing policies.

The Government will now consider the report and recommendations and will, by an Order to be published by 29 April 1997, set out its determination of maximum fares.